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February 9, 2000 **LETTER 1296**

Jan 21 DJIA 11251.71; PTI 5201; A-D Ratio -5.11
Jan 28 DJIA 10940.53; PTI 5185; A-D Ratio -5.80
Feb 4 DJIA 10963.80; PTI 5186; A-D Ratio -5.34
Dow Yield: 1.4%; Dow Price/Earnings: 23.6
Dow Times Book Value:6.48 ; PTI 89-day exp. MA: 5221
Percentage of Undervalued Blue-chips: 14%
Gold 34-day MA: 292

THE PICTURE: Over the weekend I started thinking about why I've been so fascinated with the stock market all these years, and I'm talking about the 54 years since 1947 (that's when I first became seriously interested in the stock market). At any rate, here are some of the thoughts that have gone through my mind.

Back in the 1940s, the Dow was selling consistently below 220. People in the '40s were still shell-shocked from their frightening or depressing experiences during the Great Depression (in July 1932, the Dow had dropped to as low as 41). As the Depression deepened, nobody in their wildest dreams, could have envisioned a Dow that would some day rise above 1000, much less above 10000. In fact, I remember very well the excitement and disbelief when, during November 1954, the Dow finally rallied above its old "impossible" high of 381, the high recorded on September 3, 1929.

To me the real excitement of the stock market is the unexpected, the uncanny things the market does, things that always seemed absolutely impossible "only a decade earlier." And, of course, there's the excitement at the vast changes that occur as the stock market makes its way higher during a major bull market -- or the cherished beliefs that invariably fall apart during a major bear market.

I remember sitting at the boardroom of Bache & Co. on 42nd Street at Lexington Avenue back in 1947 and watching the tape drag slowly by -- with the NYSE generating volume of just above 2 million shares a day. Compare that with the 800 million to a billion shares a day that seem normal today. And you argue, "Look, the population of the US has increased dramatically since the 1940s, so why shouldn't volume be a lot higher today?" And I answer, "The US population was about 125 million in 1947. Today the population has a bit better than doubled to 270 million. But NYSE volume? It's risen from around 2.5 million shares a day in '47 to almost a billion shares here in 2000. No, the volume today is a phenomenon, it's huge. You can't even compare it with the minuscule volume of the '40s."

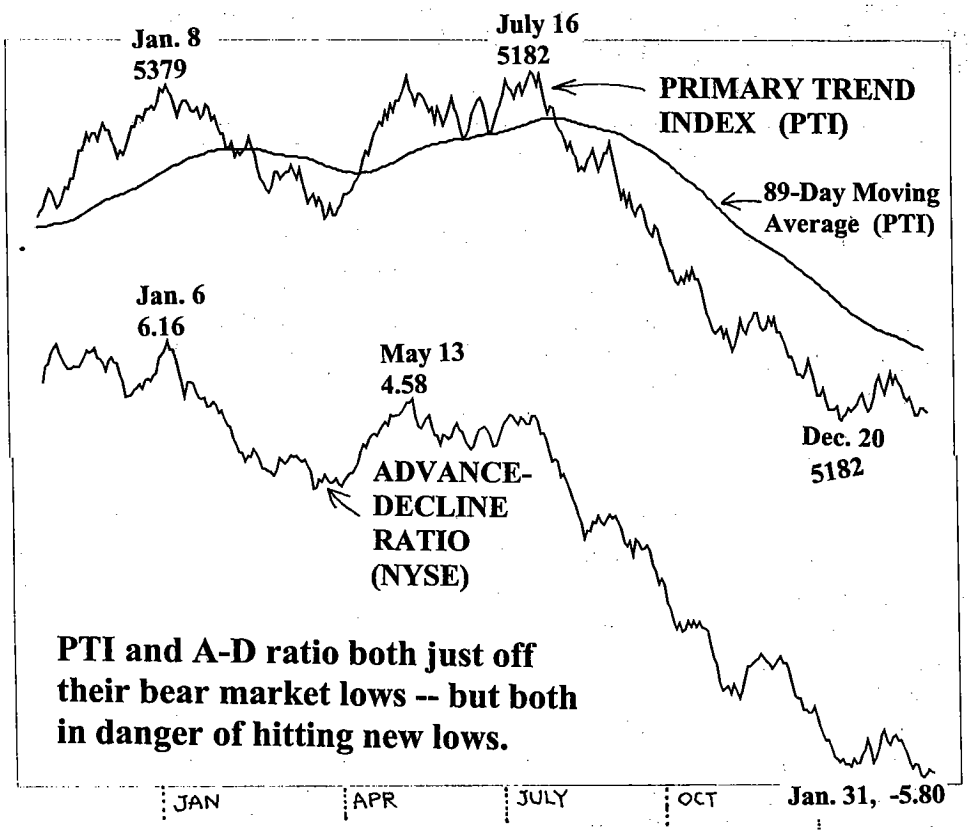
Today's volume indicates huge public interest and participation in the stock market. In fact, the stock market today has become the number one topic of conversation in every nook and cranny of the nation, from high school classes to coffee houses to local board rooms from NYC to Tampa to Seattle. Today's stock market is the biggest thing to hit the nation since World War II and I know that because I've lived through both.

Furthermore, I sit in front of the TV at 3AM here in San Diego, and I hear the CNBC bunch talking excitedly about whether a company can match its quarterly "numbers" or whether the quarterly figures will be a penny above the "estimates," or whether the "whisper number" is correct or maybe it's the "his per number." This never-ending nonsense would have been considered unbelievable even fifteen years ago. But today there is so much interest, fascination, greed and fear that the TV crowd on Bloomberg, FNN, CNN and CNBC never seem to run out of junk to talk about.

Today we have a new god in the form of the droning, verbose Alan Greenspan. The Fed Chairman has been referred to by a fawning Senator as a "national treasure," the keeper of prosperity, the greatest economic "father" since Alexander Hamilton. The nonsense, the flattery, the adulation, regarding the Green man goes on ridiculously and seemingly endlessly.

And I wonder, are these all signs of unbelievable excess? Are these all signs of maybe the greatest stock market bubble in US history? Five years from now, will we be looking back and saying, "How could we have missed it, how could we have ignored the signs? They were all there. And look at the Dow now, down at 4000."

Or wait, is this a truly new era, run by new generations that are dealing with concepts and technology undreamed of by the ancients of the 1940s? Is the market now so huge, so bullishly ingrained in the public's mind, that it will continue to rise or at worst remain in say the 10000 to 13000 area for years to come? Can the Fed with its ability to create reserves stave off anything that looks like an impending bear market? Is prosperity here to stay (even allowing for intervening rather mild recessions)?



The Market: Two weeks ago the advance-decline broke to a new bear market low. The A-D ratio topped out on April 3, 1998 and is now in one of its longest and steepest declines in stock market history. What can it mean when the majority of stocks on the NYSE decline over a period of 21 months? What are the gods of the market telling us as we experience one of the worst bear markets in breadth in stock market annals?

Very frankly, it's too early to tell. One thing is obvious -- investors are opting for quick capital gains rather than dividends or guaranteed income (bonds). The stock market doesn't readily reveal its secrets, and this is certainly one of those times. Personally, I have no objection to waiting the outcome of what I call "the great mystery." Ultimately, everything the stock market does makes sense -- but not necessarily at the time.

And again I think, everything changes, everything changes but human nature. The Internet is here, news is instantaneous, fabulous new drugs are created, aircrafts travel faster than sound, man goes to the moon." Right, but men and women still murder each other, couples still get divorced, politicians in high places are still arrested for all manner of crimes. And people still get far too bullish about stocks and the future -- and alternatively, they still get far too bearish about stocks and the future.

We know that this is by all accounts the biggest and the most overvalued and the most speculative market in history. And we know that every period of foam and froth in stock market history has been followed by a period of decline and despondency. Human nature hasn't changed. So why wouldn't the frothiest, most speculative market in history be followed by the costliest and most disheartening bear market in history?

Ah, the questions, the possibilities, the enigmas. How can you not love this business? It's the most fascinating and the most difficult of any that I know of. It's the biggest in the world, it involves multi-trillions of dollars, it involves the health of nations, it involves everything from the latest drug to the newest Internet innovation to the future of entire industries. No wonder I've been writing about it, investing in it, puzzling about it ever since 1958, the year when I first started *Dow Theory Letters*.

Retail? I've been asking this question on my daily Internet reports -- "What's going on with the retail stocks and what's going on with many of their suppliers? Why have most of the retail stocks faded while many have actually collapsed?"

And one answer I come up with (it may not be the right answer, but I think it is) is that the American consumer is up to his eye-balls in debt. He's drowning in debt. **And I think America's consumers are drawing ever-nearer to the point where they will be cutting back on their wild, unsustainable spending.**

Consumer spending constitutes two-thirds of the US Gross Domestic Product. And consumer spending is something the Fed cannot directly control. When you're spent up, when you're heavily in debt, I don't care what the Fed says or does, I don't care what kind of reserves the Fed makes available, you're going to cut back on your spending. And I think this may be what the big slide in the retail stocks is telling us. Again, the retail stocks have not just backed off, they've taken it on the chin. They've been hit very hard. And it's continuing.

And what about their suppliers? What about companies such as Maytag, Ralph Lauren, Tommy Hilfiger, Donna Karan (dear old Fruit of the Loom declared bankruptcy a few weeks ago)? All these stocks have caved in.

On top of that we have the long, tortuous decline in the D-J Transportation Average. The high for the Transports was 3783.50 recorded on May 12, 1999. The Transports are now down 1225 points or over 32% from their high. That's a major decline, and I believe it's telling us something. I tie in the long Transport slide with the collapse in breadth, and the huge decline in both of these tells me that there's something very wrong with this market. It tells me that the market is looking ahead -- and there's something about the future that this market just doesn't like. Of course, it's all been "covered up" by the excitement in the tech/net stocks.

Now we have another enigma -- we have the Dow down 4.8% in January and the S&P down 5.1% for January. Furthermore, even the Nasdaq Composite and the Nasdaq 100 were down for the month of January. During the month of January, investors generally look ahead and try to gauge the strength or weakness of the market and the economy during the coming year. Which leads to the so-called "January effect" or "as January goes, so goes the year."

Personally, I don't have a lot of faith in the January effect. Here's what I do believe. If the primary trend of the market is bullish, then a negative January will have little or no effect. But if the primary trend of the market is bearish, then a down-January is ominous.

I tracked the 11 largest S&P January declines that have occurred since 1950. Of these 11 declines, the market ended up for the year on 5 occasions and the market ended down for the year on 6 occasions. **So statistically, the figures for a down-January prove nothing.** And I'll say it again -- if the down-January occurs during a bull market the odds are that the market will end up for the year. However, if the down-January occurs during a bear market -- watch out, it's going to be a bad year.

The worst performance for a down-January occurred in 1957, when the January S&P was down 4.2%. That year the S&P ended down 14.3%. The second worst instance was in 1962 when the S&P was down 3.8% in January. That year the S&P ended down 11.8%.

The following is based on an observation that I believe is more accurate than the January effect. I call it the "December Dow effect."

The Dow low for the month of December 1999 was **10998.39.** Historically whenever the Dow breaks below its December low during the first quarter of the new year (even more importantly, when the Dow breaks its December low in January) it's a bearish indication. On this basis, the fact that the Dow broke decisively below its December low in late-January is a negative.

INVESTMENT POSITION: Based on extreme really outlandish valuations, based on new lows in both the Transports and the A-D ratio, I'm keeping the bear in the box.

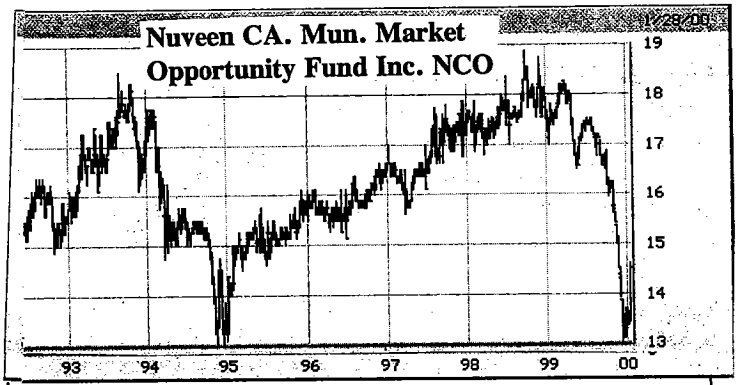
I want to draw attention to a specialized and little-known area of the market. And it's the **closed-end muni bond funds.** These stocks (mostly traded on the NYSE) have historically traded at about a 4% discount from their actual net assets. But lately they have traded at discounts of from 5% to over 12%. On top of that, last year was one of the worst years for bonds on record. As a result, the closed-end muni funds have been hit very hard from two directions. They have been hit (1) via the declining prices of the bonds they hold, and (2) by the widening discounts from actual assets as investors dumped these funds. As a result, many of these funds are now yielding 6% to even more than 7% tax free.

To differentiate, muni **mutual** funds sell at roughly net assets, but muni **closed-end** funds sell like any other stock, and like most closed-end funds, they tend to sell at various discounts from net assets. To show you how out-of-favor munis bond and muni bond funds are, last year muni bond mutual funds saw a net $12.1 billion outflow of capital. As of this writing, munis and muni funds are still out-of-favor. As measured by the Bond Buyer index of 40 long-term muni bonds, the annualized yield to maturity of long-term muni bonds is now at 6.31%, worth around 12% for an investor in the top tax bracket.

There are dozens and dozens of closed-end muni funds (almost all listed weekly in *Barron's*). There is an impressive total of about $60 billion of the closed-end muni funds outstanding.

I've been buying some of them, specifically tax free in the state of California. I would't load up on these babies but a limited amount of money in a selected few of these funds, does, I believe, represent good value.

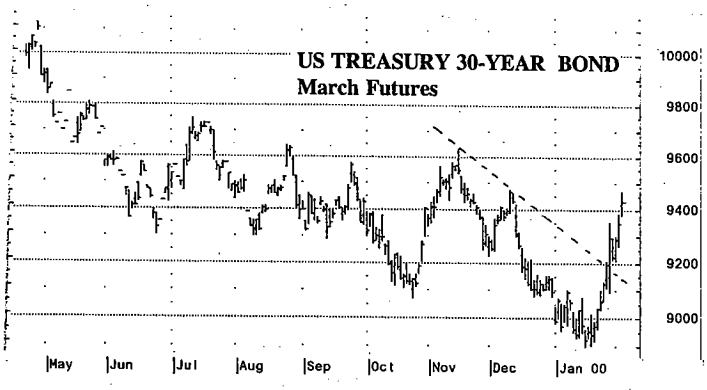
To give you an idea of what's happened to these funds, here's a ten-year chart of NCO, Nuveen Calif. Municipal Market Opportunity Fund, having been smashed to 13 in 1995, then rallying to almost 19 in 1998 and now down to just above 14. The stock yields 6.74% tax free to Californians. Back in 1995 bond yields were around 10% as compared with yields of around 6.5% today. So at present, bonds are selling near their 1995 prices, despite the fact that yields are considerably lower today than they were in 1995.

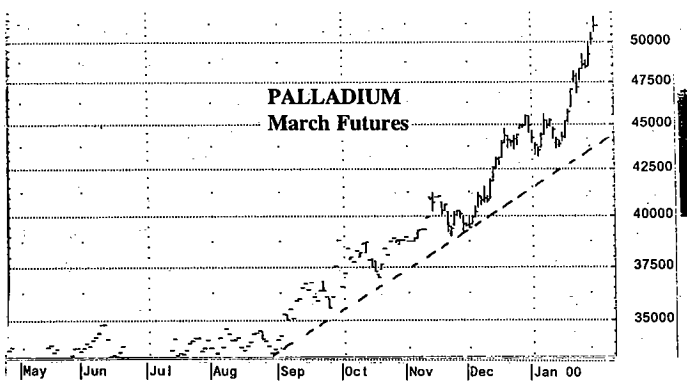


Muni funds worth looking into are as follows, and I include just the symbols: BMT, BMN, OIA, OIB, VMT, VKQ, NMI, NPP, NQC, NQR, NXC (California), NXN (New York). Research these or have your broker ("Off your fanny, Charlie") do it for you. All yield 6% to above 7% and are still historically "cheap."

In general, I now advise a very conservative market position, with investors mostly in US government debt, anything from 91-day T-bills to 10-year notes. Why mess around further with the most overvalued, over-hyped stock market in US history?And yeah, I know that Abby Cohen now thinks the market is "fairly priced." I don't .

NOTES & QUOTES: Movers: With the Treasury moving to buy back a multi-billion dollar load of long T-bonds, the 30-year T-bond has exploded as investors rush to load up on them. This chart shows the story.





Second explosion: palladium used in catalytic converters in cars. With Russia producing two-thirds of the world's palladium and with Russian production ebbing, the metal has surged to over 500 bucks an ounce, leaving gold and silver far behind. Platinum, also used in converters, is above 475 and appears to be heading for 500.

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Why did McCain kill Bush in New Hampshire? My opinion: voters are tired of being told who to vote for, and they resent a situation where the party puts up the candidates and literally dictates to the voters who they must vote for. Bush was and is the choice of all the Republican party big-wigs. Second, and very important, after suffering through Clinton and his crowd, voters want a president of unimpeachable honesty and character. McCain is that man, Bush is well, questionable, he's too slick and has a tainted background.

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Day-trading, anyone? The SEC counts 300 day-trading offices across the face of the US; these offices serve roughly 10,000 day-traders. These specialized offices boast high-speed computers, charts, paraphernalia, and they claim that this gives their clients the same kind of advantage that the "big boys" have with all their high-tech equipment and high-fi intelligence.

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Probably the hottest "play" on the NYSE is the arbitrage play based on the forthcoming AOL/Time Warner merger. By buying shares of the target company (Time Warner) and selling AOL short, the players lock in the "spread," regardless of when the deal is completed. On the first day the deal was announced, the spread was around 17, but the spread has steadily declined to currently around 7. The "smart move," say some, is just to buy AOL. If the deal is called off, AOL should advance (AOL's high was 92 and AOL is now down over 40% from its high). But if the deal goes through, AOL should still rise -- but rise more gradually. Anyway, that's the theory. **Russell advice:** Leave it alone.

* *

On January 26, the news came out that consumer sentiment was the highest in history, higher even than the previous peak which occurred in October 1968, just a month before the market topped out and then headed down in earnest. This headline from the cover of US News & World Report also reflects the wildly bullish psychology of today.

Consumer Confidence in Economy Hits New High

By Yochi J. Dreazen
Staff Reporter of The Wall Street Journal

WASHINGTON—With unemployment continuing to fall and the economic boom nearing a record as the longest in U.S. history, consumers are more confident than at any time in the past 31 years, a private survey found. But there are signs that the economy may be headed for at least a partial slowdown.

Specifically, the percentage of households saying they planned to buy a new home in the next six months slipped 0.7% in January. The housing market is often the first to feel the effects of a slowdown in the economy because it is the most sensitive to changes in interest rates. The percentage of households planning to buy a major appliance falling while the percentage planning to buy a new car rose slightly.

The index that measures households about the

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Despite all the publicity, day-traders don't tend to do that well. A small percentage of day-traders do well, these are the guys and gals you hear about, but the great majority of day-traders get ground up and spit out by the markets. An SEC study found that 67 out of 68 day-traders were losers. Another SEC study found that 7 out of 10 day-traders lost ALL their money. Furthermore, commissions tend to kill day-traders. A recent study showed that on average day-traders run up such high commissions (in and out trading) that most must earn 56% returns just to break even. This is better than what Warren Buffett does, and Buffett is famous for his long-term record.

A trading group with a great record is the Hull Group, which was recently bought out by Goldman Sachs. Says Blair Hull, founder of the group, "Our view is that if a trader has a mouse in his hand, he's already too slow." Maybe that's all you need to know. Mull it over, if you get the urge to day-trade.

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I've said all along that the Internet is a force for deflation. This column from the Jan. 18 *Investor's Business Daily* asks the question, and as far as I'm concerned the answer is "Yes, the Internet is an anti-inflationary force." I recently saw a list of commonly used items that you buy in the stores. Against this, was a comparison of these items as offered on the net. The discounts were striking, and, of course there's no sales tax on the net (although I don't know how long that will last). At any rate, one of the "blessings" of the net is that the consumer has gained a lot of power. As for the corporations, that's another story. And what happens when foreign competition climbs on the net? That hasn't really started yet.

NATIONAL ISSUE

IS THE INTERNET KILLING INFLATION?

Savage Web-Driven Price Wars Return Power To Consumers

By Joseph Guinto
Investor's Business Daily

A just-released video collec- "A . . . them say the future of Net sales may be driven by consumer loyalty to certain shopping sites and to

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I sent away and just received (free) a video on the new i-opener which appears to be a very easy way to get **on the Internet without a computer.** You plug the i-opener in to an electric outlet, plug the other wire into a phone line, and presto, you're on the net. For all my net-averse subscribers, I suggest that you send away for this free video: call 1-888-467-3637. Even if you don't end up buying the i-opener, the video is very well done and very informative.

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The *Economist* magazine's cover story for January 2 was "A Tale of Two Debtors." The two are Japan and the US. The Japanese problem-debt is its public debt. Writes the *Economist*, "The Japanese government will by the end of the year have the biggest debt (as a percentage of GDP) that has ever been owed by an developed country during peacetime. . . Many fear that Japan is heading for a public-service debt crisis. . . Japan's gross public debt has become gross indeed, amounting to 128% of GDP. . . up from 69% in 1990. This makes the Japanese government the biggest borrower in the rich world. . . And yet even as the American government has weaned itself from its old borrowing habits, American households and firms have been borrowing hand over fist, lifting their combined debts to a record 132% of GDP. It is these debts which could make the economic consequences of a stock market collapse more serious and more damaging than most people suspect. . . America's private-borrowing binge should never have been allowed to go on for so long. It looks as if American policymakers learned nothing from the errors of their Japanese counterparts in the 1980s, when private borrowing was allowed to rip. The cost to Japan was years of recession and sluggish growth. Americans, not to mention the rest of the world, should be praying that their economy will not have to pay the same price."

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The US trade balance for November was very ugly, negative by $26.5 billion and running at the rate of almost $400 billion a year. I don't know how much longer this can go on without bringing on trouble for both the dollar and interest rates. After all, at some point our friends overseas are going to want higher interest rates in return for taking in additional mountains of dollars. The dollar has been holding up very well, so far, but if our trade balances continue to be this ugly, then somewhere ahead the trouble is going to hit.

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What's the Internet all about? A new book just out is entitled *Weaving the Web: The Original Design and Ultimate Destiny of the World Wide Web* by its investor Time Berners-Lee (Harper-San Francisco, 1999 $26) The net originated in Berners-Lee's mind and matures slowly. There was, he says, no "Eureka" moment. Instead, he thought, "Suppose all of the information stored on computers everywhere was linked, I thought (in 1980). Suppose I could program my computer to create a space in which anything could be linked to anything." The structure he envisioned would overcome the incompatibility among computers that make them unable to communicate with each other. Berners-Lee is director of the World Wide Web Consortium and at the same time he occupies the 3Com Founders chair at MIT Technology Laboratory for Computer Science.

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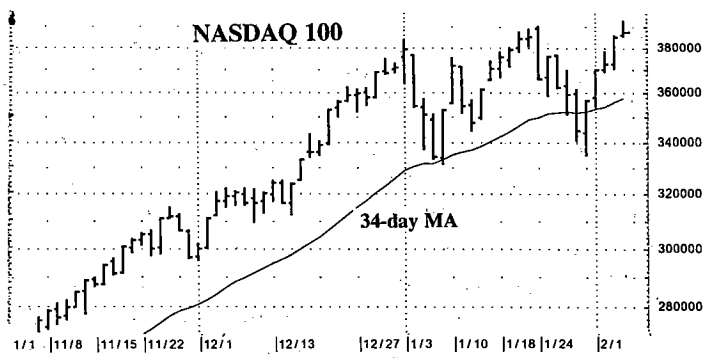
The following fascinating analysis is from *Personal Finance* (800- 832-2330). "A Qualcomm recommendation projects that 12 billion cell phones will be sold over the next decade and that 85% of those phones will use Qualcomm technology. This works out to about two phones for every person in the world, including famine-swept areas of Africa. Think what *Mad Magazine* would do with that! Moreover, the prediction that QCOM's market share will rise to 85% from its current 18% level seems to rest on an

assumption that no competing technology will develop over the next decade to challenge it -- an assumption that's tough to swallow, to say the least. . . For Amazon, which has yet to prove it can earn a cent, one major brokerage house projected a 50-fold increase in revenues over the next decade. One wonders where they'll get the money to spend in inventories and warehouses, especially when immeasurably better financed companies like Wal-Mart enter the Internet fray, full force as competitors."

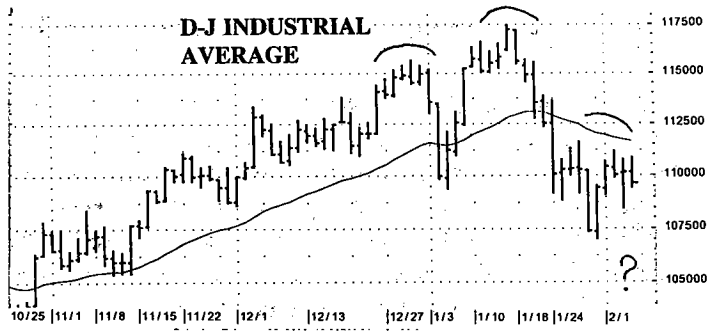
LATE NOTES & CHARTS: The first chart shows the **Nasdaq 100 (NDC5)**, the index which includes the hundred largest Nasdaq stocks. This index is where the extreme speculation and overvaluation is centered. Every fund manager feels that, regardless of price, he must have representation in this area. There's no question in my mind that what we're seeing here is the "cult of technology." Obviously, the implications of the Internet and the revolution in communication are tremendous. But that doesn't mean that the **great majority** of the tech/net companies have to generate profits. In the end, it isn't "eyeballs" or hits on your website that will control the price of your stock, it's the trend of profits, if indeed, there ever are any profits.

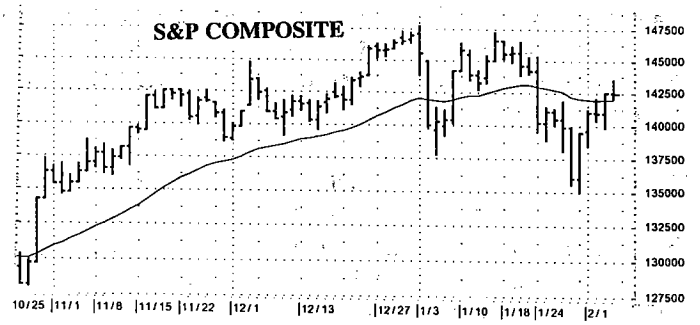
NDC5 is clearly bullish, having hit a new record high last week. NDC5 has been walking up and above its 34-week moving average for months. The first sign of trouble would be this index falling below its 34-week MA (now 3579) and then remaining below that MA. That hasn't happened yet.



The next chart shows the **D-J Industrial Average.** This chart is particularly interesting in that the Dow broke below its 34-day MA on January 21, and it has remained below the 34-day MA since that time. I continue to see the Dow as being in a distribution pattern with the latest action being part of the right shoulder of a potential head-and-shoulders top. The 34-day MA now stands at 11163. Breaking above that number would be bullish for the Dow. Dropping below its 144-day MA (which stands at 10889) would be bearish.

The third chart shows the broad **S&P 500.** It's clear that the S&P is acting stronger than the Dow. As this is written, the S&P has rallied just above its 34-day MA. The big question here is whether the S&P has the strength to attack, and then better, its record high close, The record high close was **1469.25** recorded on December 31.

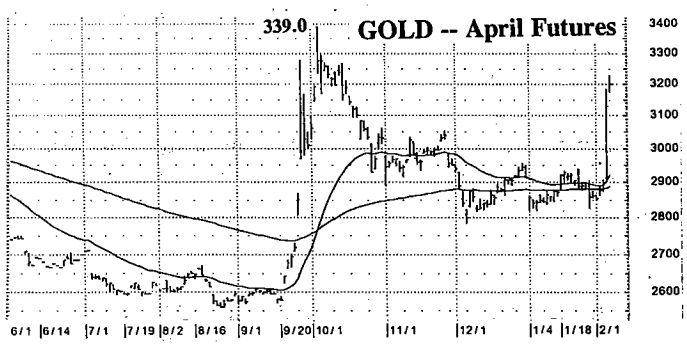




GOLD: Ah, at last, I have something worthwhile to write about in the gold and precious metals area. In a word (or phrase) "they're moving up." Of course, as subscribers on my net site know, palladium and platinum have been rocketing higher for weeks, but we can call that special circumstances, since most of these metals come from Russia, and when you depend on Russia for production you've got problems.

But gold, that's a different story. Last week Placer Dome announced that they were not going to sell any more forward gold, and at the same time some inflationary figures were released by our government. That did it. On Feb. 24 gold surged, with the active April futures climbing to 318.50 and settling at 313.00. This surge took April futures well above both its 34-day and the 144-day moving averages, all of which triggered a "buy signal" on the Russell method of reading the moving averages.

The next step, if indeed there is one, is a tough one. To look really, really impressive April gold will have to better its previous peak of 339 recorded on October 3. That should take time and it won't be easy.



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